FINANCING THE MARKET-BASED REDISTRIBUTION OF LAND TO DISADVANTAGED FARMERS AND FARM WORKERS IN SOUTH AFRICA: RECENT PERFORMANCE OF THE LAND REFORM CREDIT FACILITY

Michael Lyne[1], Paul Zille[2] and Douglas Graham[3]

This paper compares the results of public and private land redistribution in the province of KwaZulu-Natal, South Africa. It identifies problems that constrain access to the land market, and describes recent efforts to address the liquidity problem associated with mortgage finance. The Land Reform Credit Facility (LRCF) was launched by government in May 1999 to help alleviate cash flow problems on farms purchased by disadvantaged buyers and financed with mortgage loans from commercial banks. The LRCF does not offer subsidies. Rather it offers loans with deferred or graduated repayment schedules to reputable banks and venture capital investors who finance, on similar terms, equity-share projects and land purchased by aspiring farmers. The paper outlines the LRCF experience and considers reasons for its promising start. The loan target of R15 million (US$2.15 million) set for the first year was reached after only eight months.

1 INTRODUCTION

Land reformers in South Africa had generally accepted the notion of market-based land redistribution prior to 1994. In the months leading up to the first democratic election in the country, the debate focused on what the future government should do to help historically disadvantaged[4] people access the land market. Should it offer cash grants to disadvantaged buyers or should it subsidize the loans they use to finance land and equity in commercial farms (World Bank, 1993:33-37; Nieuwoudt *et al*, 1994; World Bank, 1994; Nieuwoudt and Vink, 1995)?

This paper reviews programs emphasizing the liquidity aspects of cash grants and finite, diminishing interest rate subsidies. It briefly describes the application of these programs and presents evidence from the province of KwaZulu-Natal suggesting that government land grants have performed poorly in terms of both land redistribution and the efficient use of farmland. We then describe a new loan product introduced by the Land Reform Credit Facility (LRCF) to

---

1 Pofessor in agricultural economics at he University of Natal, Pietermaritzburg, South Africa.

2 Manager of the Land Reform Credit Facility based at Khula Enterprise Finance Ltd, Johannesburg, South Africa.

3 Pofessor in rural finance at The Ohio State University, Columbus, Ohio, USA.

4 The term ‘disadvantaged’ refers to individuals who were excluded from land markets on the basis of racial segregation under former apartheid legislation. This includes people who were defined as Black, Indian and Colored.

alleviate liquidity problems that discourage private banks and venture capital investors from financing aspiring farmers. Although the LRCF does not provide guarantees or subsidies for its loans, the response by financial institutions has been strong with loan disbursements reaching the first year's target of R15 million in just eight months. The purpose of the paper is to describe the LRCF product, to consider reasons for the Facility's promising start, and to identify problems that have prevented it from reaching further down the income scale for its beneficiaries.

2 CASH GRANTS VERSUS FINITE, DIMINISHING INTEREST SUBSIDIES

In their proposals for land reform in South Africa, the World Bank (1993) made a case for cash grants to help disadvantaged farmers finance land. This recommendation is consistent with Binswanger's (1987) argument that poor people are unable to finance land with unsubsidized mortgage loans, particularly when the market value of land exceeds its 'productive' value. According to Deininger and Binswanger (1992) the market value of farmland in South Africa exceeded its productive value owing to a long history of subsidies granted to white commercial farmers. This explanation of the liquidity problem was disputed by Nieuwoudt and Vink (1995) who countered that the removal of subsidies would not make it any easier for prospective buyers to finance land in South Africa because the underlying problem was high inflation. Inflation increases immediate costs (higher interest rates) while deferring returns (future rents increased by inflation). The result is inadequate cash flow to service debt during the first critical years after purchase. This distinction has important policy implications; in the latter case the direct role of government can be reduced, and commercial banks and private venture capital investors could play a leading role in financing land redistribution.

An investment in land is similar to an investment in the stock market in that current returns (dividends) are low relative to capital growth. Empirical evidence from South Africa shows that the average annual current return to agricultural land seldom exceeds five per cent of its market value. During periods of inflation when nominal interest rates are high (say 17% per cent per annum) relative to the current return on agricultural land, mortgage loans with constant repayment schedules create formidable but temporary liquidity problems for borrowers who are unable to make a substantial down-payment on the purchase price of a farm. The liquidity problem diminishes over time because inflation raises earnings relative to the constant flow of loan repayments[5]. One method of addressing the problem is to graduate the loan repayments by subsidizing the interest charges at a decreasing rate over a finite period of time.

Nieuwoudt and Vink (1995) demonstrated that cash grants and diminishing interest rate subsidies impact differently on a beneficiary's cash flow. In particular, an interest rate subsidy that diminishes at the rate of inflation can completely eliminate cash flow problems in the first few critical years after entry whereas a cash grant (drawing the same level of public funding) does not. In their case study they show that the interest rate subsidy will phase out after 11 years if the annual inflation rate is 12 per cent and the beneficiary pays (an affordable) five per cent interest on full purchase

---

[5] In South Africa, mortgage loans are usually amortized with constant repayments of interest plus principal. If nominal interest rates change following a change in the rate of inflation, amortization schedules are adjusted yielding a new, constant level of remaining repayments. It is important to note that these changes in nominal interest rates represent relatively small changes to the existing (high) level of inflation. As a result, the cost of servicing debt diminishes relative to borrowers' income, which grows at the full rate of inflation.

price in the first year. This approach was adopted by the private sector and Ithala Bank, but the government opted for cash grants.

2.1 The land grant

Since 1995, the main tool employed by government to redistribute land has been the settlement-land acquisition grant. In terms of this program, historically disadvantaged South Africans who are landless and poor may qualify for a cash grant (initially R15,000 per beneficiary household) to purchase and develop farmland. In practice, beneficiary households have to pool their meager grants in order to buy a farm from a willing seller. The group establishes a legal entity (usually a trust or communal property association) which is formally registered as the owner of the property. In most cases, farms financed with these grants and settled by groups (of up to 500 households) were much too small to support all of the beneficiaries as full-time farmers. Section 3 reports some adverse consequences of the grant program and describes recent policy changes intended to shift resources towards aspiring farmers and commercially oriented land redistribution projects.

2.2 The finite, diminishing interest subsidy

In KwaZulu-Natal, private land transactions have been facilitated by the Ithala Bank since 1996. Earlier, when the Illovo Sugar Company invited applications for 20 medium-scale sugarcane farms (ranging from 55 to 105 hectares in area), none of the more than 100 disadvantaged applicants could afford an equity contribution large enough to reduce the size of a conventional mortgage loan down to a level that could be serviced from farm income. To mitigate this problem the company agreed to sell the farms at market-related prices and to invest 18 per cent of the purchase price with Ithala bank. This capital, plus accrued interest, funds a finite interest rate subsidy for the borrower. In effect, Illovo Sugar Company discounted the price of its land by 18 per cent, and the Ithala Bank used this private subsidy to reduce the current mortgage loan rate from 16.5 per cent to ten per cent in the first year. The subsidy then declines to zero at the end of year six, in line with expected increases in nominal income associated with an annual inflation rate of roughly ten per cent. The buyer pays the full annual interest rate of 16.5 per cent for the remaining 14 years of the 20-year loan period (Simms, 1997).

Ithala's program has been criticized as elitist because it benefits disadvantaged farmers who are relatively wealthy and creditworthy. To qualify, a beneficiary must contribute approximately R90,000 (10 per cent) towards the purchase price of his or her farm. Nevertheless, the program has attracted support from other estate owners and financed 90 medium-scale farms with a combined market value of almost R80 million during 1997 and 1998. Early indications are favorable in the sense that the vast majority of these farmers are meeting their loan obligations and maintaining high yields (DLA, 1998:12).

In South Africa, the cash flow constraint has been compounded by another major impediment to private land transactions - the Subdivision of Agricultural Land Act, 70 of 1970. This Act imposes an 'economic' farm size that is beyond the means of most aspiring farmers, compelling them to borrow heavily in order to purchase a farm. Although Act 70 was repealed, the repeal has not been signed into law by the President. The delay has been attributed to the absence of national zoning legislation regulating the conversion of agricultural land into residential or industrial uses (Graham, 2000:19). Repeal of Act 70 will make smaller farms more affordable to part-time farmers, and mortgage finance much less elitist.

3 LAND REDISTRIBUTION IN KWAZULU-NATAL

> KwaZulu-Natal is one of nine provinces in South Africa. It is the largest province in terms of population (about nine million people) but relatively small in area (about nine million hectares). At the time of South Africa's political democratization in 1994, 55 per cent of the farmland (excluding national parks) in KwaZulu-Natal was controlled by a small minority of white owners. It is estimated that 6,755 large-scale commercial farms accounted for 4.1 million hectares. Of the remaining 3.3 million hectares, 2.84 million hectares was occupied by some three million black South Africans under communal tenure, 0.04 million hectares was privately owned by 'non-whites', and 0.42 million hectares was farmed by the state itself (Lyne and Ortmann, 1996).

The distribution of farmland is even more skewed against historically disadvantaged people in the rest of the country. Clearly, land redistribution is a necessary prerequisite for political stability and hence economic growth in South Africa. At the same time, it is important to ensure that the efficient use of commercial farmland and other agricultural resources is not compromised in the long-term.

Graham (2000:21-32) conducted census surveys of farmland transactions in KwaZulu-Natal during the calendar years 1997 and 1998. The transfers of ownership recorded in Table 1 represent the subset of transactions from white sellers to non-white buyers. In addition, Graham included transfers from men to women within the historically disadvantaged group, so that his definition of 'disadvantaged' refers to all individuals who were previously excluded from land markets on the basis of racial and gender segregation.

Table 1: Characteristics of farmland by mode of redistribution in KwaZulu-Natal, 1997-98 (1998=100)[a]

Farm characteristic	Government – assisted		Private mortgage		Private cash		Inheritance & donations	
	1997	1998	1997	1998	1997	1998	1997	1998
# of transactions	21	4	43	26	50	62	69	91
Total market value of land (R million)	14.38	2.24	33.87	16.74	5.21	7.88		
Total area of land (Ha)	12,022	4,382	6,459	5,757	3,242	6588	1,210	2,158
Weighted land price (R/Ha)	1,196	510	5,243	2,907	1,608	1,196		

[a] At the end of 1998, 1US$ = 5.88 Rand.

Source: Graham (2000:28).

In Table 1, government-assisted transactions refer to farms purchased by the beneficiaries of government land grants. The other column headings in Table 1 refer to private transactions, and distinguish between farms financed with mortgage loans, cash purchases, and farms inherited by (or donated to) disadvantaged people. It is clear that private purchases (*ie* transactions financed without government grants) redistributed much more land wealth than did government-assisted transactions – despite major impediments in the form of high nominal interest rates and legislation curbing the subdivision of large farms into smaller, more affordable, units.

In 1997, private purchases accounted for 73 per cent of the total value of all land redistributed through market transactions to disadvantaged buyers in the province. This proportion increased to 91 per cent in 1998. In area terms, government-assisted transactions accounted for 52 per cent and private transactions 48 per cent of the land redistributed in 1997. By 1998, these percentages had shifted markedly to 23 and 77 respectively, underscoring the relative decline in government-assisted transactions. Donation and inheritance transactions accounted for a relatively small area of the farmland transferred to disadvantaged people. However, these private transactions tended to benefit women whereas those financed with cash or mortgage loans were dominated by men (Graham, 2000:63-64). Women (as sole owners or married co-owners) gained less than half of the total area acquired by men (as sole owners).

Government's poor performance in redistributing quality farmland has been compounded by other problems. In their rush to redistribute land to a large number of poor people, the Department of Land Affairs did little to help diverse groups of beneficiaries adopt sound constitutions to manage communal resources or to assign exclusive property rights to individual beneficiaries. This institutional vacuum has already generated highly visible adverse outcomes on government land reform projects: Commercial farmland has been needlessly lost to residential uses, private ranches have been converted into open access grazing resources, and insecure tenure has undermined investment in crop production (Lyne and Graham, 2000).

Table 2 is taken from Lyne and Graham's (2000) study which uses a block-recursive model to demonstrate that insecure tenure has impacted adversely on beneficiaries' ability and incentive to finance seasonal inputs and improvements to cropland. The tenure index reported in this Table was constructed from the breadth and assurance of property rights perceived by respondents sampled on commercial farms acquired with and without government assistance[6].

[6] Lyne and Graham (2000) used the theoretical framework proposed by Place *et al* (1994:20-22) to construct an index of tenure security measuring the breadth and assurance of property rights to land.

Table 2: Parcel-level descriptives for sample households using redistributed farmland in KwaZulu-Natal, 1999

	Government-assisted projects	Private transactions	F-statistic for group means
	Mean	Mean	
Tenure security (parcel index score)	22	47	73.0**
Agricultural credit (R/Ha)	18	3,853	27.8**
Land value with improvements (R/Ha)	1,728	8,882	413.9**
Crop inputs (R/Ha)	293	945	5.8 *
Crop sales (R/Ha)	22	4,718	79.9**
Extension contact (visits in past month)	0.04	0.78	10.2**
Parcel area (Ha)	2.5	61.6	39.4**

** Significant at the 1% level of probability.

* Significant at the 5% level of probability.

Source: Lyne and Graham (2000).

Viewed against this background, it is not really surprising that government policy has shifted in favor of creditworthy land reform projects. In 1996, the Department of Land Affairs (DLA) made the land grant available to farm workers for the purpose of financing equity in established commercial farming enterprises. Equity-sharing projects are company operations in which financial equity is shared between the previous owner and his farm workers. Farm assets are owned by the company and enterprises are managed by an experienced farmer, frequently the former white owner who is usually the majority shareholder. Importantly, these companies have been able to attract additional finance from banks and venture capitalists. Private financiers have an incentive to help their clients build sound business organizations and to train worker-shareholders for their participation in a successful company. Equity-sharing projects were initiated by white farmers in the Western Cape province and have been effective in redistributing land and wealth while improving agricultural performance (Eckert *et al*, 1996).

In theory, agricultural performance is expected to improve because benefits and voting rights are directly related to the level of investment made by individual shareholders. While recognising the future potential for dividends and capital gains, field interviews have shown that workers' immediate interest in joining equity-sharing projects centres more on the opportunity to influence managerial decisions affecting wages, working conditions, housing and tenure security for their families (DLA, 1998:5). However, the extent to which these projects do empower workers has been questioned (SPP, 1999). This weakness stems largely from the problem that workers are seldom able to buy a significant shareholding with the small grants awarded by the DLA.

In May 1998, the DLA appointed a group of consultants (including the authors) to explore ways of using public and donor-sponsored funds to help disadvantaged farmers and farmworkers access loans from the private sector to finance land and equity-sharing projects. Any thoughts of using these funds to pay for a finite, diminishing interest subsidy were dashed when the DLA ruled out subsidies or loan guarantees. As an alternative, partial solution to the liquidity problem the consultants (DLA, 1998:22-26) recommended that the funds be offered to reputable lending intermediaries (*eg* commercial banks and private venture capital companies) as loans with deferred or graduated repayments. Section 4 presents a case study demonstrating the impact of a 'deferred loan'.

In June 1999 the African National Congress was re-elected as the governing party in South Africa and a new Minister (Thoko Didiza) was appointed to the portfolio of Agriculture and Land Affairs. Shortly after her appointment, the Minister imposed a temporary moratorium on all land related grants pending a review of the policies (including DLA support for equity-sharing projects) developed by her predecessor. Recent changes to the grant program (DLA, 2000) emphasise a shift in favor of aspiring farmers who wish to purchase, improve and expand their own farms. While the basic settlement-land acquisition grant has been increased in nominal terms to a level of R20,000, beneficiaries who have experience or training in agriculture can leverage additional grant funding by investing increasing amounts of their own and borrowed capital in the farming enterprise that they wish to finance. A beneficiary must contribute private finance totaling R400,000 in order to qualify for a maximum of R100,000 in grant funding. At the time of writing, the DLA had not completed its review of equity-sharing projects nor had it finalized procedures governing the award of graduated grants. Nevertheless, the Minister has indicated that both the basic and graduated grants will be made available to farm workers who wish to purchase equity in established commercial farms (Cochrane, 2000). This would certainly make it easier for farm workers to increase their shareholding over time, leading to greater empowerment in equity-sharing projects.

4 A CASH FLOW CASE STUDY

Appendix Table A1 presents an actual cash flow projection and narrative drawn from a loan application to finance an equity-sharing project in the Western Cape (Graham and Lyne, 1999). The 'deferred loan' option was not considered in this actual case. Nevertheless, it has been introduced into the cash flow projections to show that, under certain conditions, deferment can make a project more attractive to financiers.

In this example, a commercial fruit farmer agreed to sell his farm to a company with equity shared between himself and 30 employees. The farm's assets were to be sold to the company for R2 million. The company intended to finance these assets using both debt and equity capital. It hoped to borrow R1 million from a commercial bank. This debt capital would cover one-half of the purchase price. The remaining half was to be financed from equity capital provided by the farmer and his workers. The farmer would contribute R0.55 million and each worker would invest his or her land grant of R15,000 bringing labors' contribution to R0.45m.

In this case, the farmer would own 55 per cent of the equity while the workers jointly own 45 per cent. Together, the workers would capture 45 per cent of dividend payments and capital gains (or losses). They would also control 45 per cent of the votes cast when electing directors to the company's board of directors, giving them some influence over company policy. However, commercial banks rejected the loan application because the cash flow projected for the farming enterprise would not service a loan with constant repayments of interest plus capital during the first critical years.

Appendix Table A1 shows that conventional loan finance renders the proposed project illiquid shortly after its inception. The net cash flow in column 3 is strongly negative after two years. To resolve the liquidity problem, the lender could agree to defer loan repayments for a period of two years with full interest charges accruing on the outstanding loan balance (column 4). This deferment would enable the company to retain part of the cash surplus expected during the period of deferment (or graduation) to augment dividends in later years when reinvestment is expected to sap its liquidity (column 5).

From the borrower's perspective the tradeoff is that profits decline as the deferment period lengthens. In this example, returns to equity fall by just 0.36 per cent over a twenty-year horizon because the deferment period is relatively short and there is real growth in the projected cash flow. From the financier's perspective, the problem is that loans or direct venture capital equity investments with deferred repayment simply shifts the cash flow problem to themselves (*ie* their own shareholders). Small wonder then, that private financiers did not pursue this strategy.

5 THE LAND REFORM CREDIT FACILITY

The Land Reform Credit Facility was launched at the end of May 1999 with the aim of drawing private sector finance and human capital into commercially viable land reform projects (LRCF, 1999). The Facility offers loans with deferred or graduated repayment schedules to reputable banks and venture capital investors who finance, on similar terms, equity-sharing projects and land purchased by aspiring farmers. In essence, the LRCF inherits the (temporary) cash flow problem.

Loans granted to financial intermediaries must have a deferred repayment schedule consistent with that designed by the intermediary for the enterprise it is financing. Otherwise, intermediaries are free to negotiate retail interest rates with their clients. Private lenders and investors who apply for loans from the LRCF are expected to conduct their financial evaluation and screening of projects thoroughly, adhering to sound business criteria, as they are putting their own resources at risk. At present the LRCF is administered by one full-time manager as there is no need to conduct or review these financial analyses. Rather, the manager's principal task is to approve loan applications submitted by accredited financial intermediaries according to land reform criteria established by the DLA[7].

The LRCF was capitalized with an initial sum of R63 million, of which foreign donors granted R31 million (LRCF, 1999). Simulation exercises based on anticipated loans with deferment periods ranging from one to three years suggested that approximately 23 per cent of these initial funds

---

[7] The DLA imposed five criteria to promote outreach, empowerment and tenure security among land reform beneficiaries. For lenders financing land purchased by aspiring farmers: (a) the purchase price of the real estate and farm assets must not exceed R600,000 per beneficiary (valued in 1999 Rands) and (b) the land price must not be less than one-tenth of the Rands borrowed. Similar conditions apply to intermediaries financing equity-sharing schemes except that the purchase price of the real estate and farm assets must not exceed R400,000 per beneficiary. In addition, (c) venture capital investors should not own more than 50 per cent of the equity in these schemes, (d) the equity purchased by workers in aggregate should exceed their annual wage bill, and (e) worker-shareholders should at least be offered long-term rental contracts for residential sites on or nearby the company farm.

(R15 million) could be disbursed in the first year without reducing the real value of the fund to a level where it would not recover in the longer term.

In June 1999 the manager drafted and circulated guidelines for applications to the LRCF. By 16 August 1999, he had received loan applications for R6.5 million, notice of applications totaling R14.4 million, and had also been approached by intermediaries to discuss loans for a further R76.9 million to finance eco-tourism equity-sharing projects (LRCF, 1999). As several of the applicants were not internationally accredited, the LRCF had to develop a due diligence framework to assess the creditworthiness of non-accredited intermediaries. In addition, the new Minister of Agriculture and Land Affairs imposed a temporary moratorium on land related grants while reviewing policies inherited from her predecessor. Despite these setbacks, the LRCF approved four loans totaling R14.6 million before the end of January 2000, just eight months after its launch. Loan terms ranged from seven to 20 years and deferment periods from two to six years. Three loans were made to venture capital investors and a commercial bank to finance two equity-sharing projects benefitting 29 previously disadvantaged workers (and their families) as shareholders. The fourth loan, to Ithala Bank, will finance eight mortgage loans made to individual farmers, each acquiring approximately 100 hectares of fully developed sugarcane estate. A further two loans (together worth R11 million) are being processed for disbursement early in the LRCF's second year of operation. Possible factors contributing to this positive response by financial intermediaries include:

- The LRCF loan product has improved the risk profile of its end clients by alleviating a cash flow problem that renders many profitable land reform projects financially infeasible.
- The wholesale interest rate charged by the LRCF implicitly subsidizes the cost of capital to financial intermediaries.

Interest rates charged by the LRCF are currently fixed at between one and three percentage points below the three-month Bankers' Acceptance (BA) rate. The largest discount (three percentage points) is granted only to internationally accredited institutions for the purpose of financing equity-sharing projects in which disadvantaged shareholders together own more than 20 per cent of the equity. These discounts were considered to be market-related as the LRCF deals with reputable financial institutions, its loan terms are long and its transaction costs low. Larger discounts have been proposed for projects that allocate larger shares of equity to disadvantaged people. In retrospect, Zimbabweans currently facing the consequences of widespread farm invasions might have been willing to countenance a small distortion in their capital market in order to redistribute wealth in commercial agriculture by subsidizing the cost of mortgage loans with deferred or graduated repayment schedules.

On the other hand, there are at least three problems that have seriously discouraged applications to finance less elitist projects:

- LRCF loans were designed to link up with a grant from the DLA's Community Facilitation and Support (CFS) fund to help end clients cover the costs of organizational development, technical training and managerial mentoring. This support is of particular interest to financiers and investors, given the relative inexperience of the new owners and co-owners. However, a moratorium on grants from the CFS fund was recently extended by the DLA to review affirmative action principles in the procurement of support services.
- The Subdivision of Agricultural land Act, 70 of 1970 makes it unduly difficult and expensive to partition large farms into smaller units. This has prevented the LRCF from

reaching poorer farmers who cannot meet the equity contribution required to finance a large or medium scale farm.

· DLA land grants are vital to the success of the LRCF because farm workers and aspiring farmers cannot make significant contributions of their own to the purchase of equity and land. Although the moratorium on land grants has been lifted and future grants are expected to be larger, financial intermediaries will not submit loan applications to the LRCF for projects that hinge on land grants because the DLA may not approve the grants or, if it does, is unlikely to disburse the grants expeditiously. The lead time from application to disbursement of these grants is currently 18-24 months.

The DLA intends to reduce lengthy delays (of up to two years) in the disbursement of land grants by decentralizing the approval process. However, the proposal still involves high transaction costs as it recommends an interdepartmental provincial committee advised by agricultural consultants. An unfortunate consequence of missing and inadequate grant funding has been the emergence of equity-sharing projects in which workers are not adequately empowered. This problem received attention in a recently (July, 2000) commissioned evaluation of the LRCF. Recommendations relating to selection criteria and interest rate discounts are expected to enhance the outreach and empowerment aspects of future projects financed through the LRCF.

6 SUMMARY AND CONCLUSIONS

In summary, the government faces a challenge of financing the redistribution of commercial farmland from white commercial farmers to historically disadvantaged buyers, on a willing seller - willing buyer basis. Moreover, this process should be carried out so that a large number of beneficiaries are served and, at the same time, a strong commercial orientation is maintained on the new properties. To date, government-sponsored land settlement grants emphasized the former objective at the expense of the latter. With current legislation restricting the subdivision of commercial farmland, poor beneficiaries had to pool their grants to meet the purchase price of a farm. These groups, represented by trusts or communal property associations, were often too large to negotiate sound constitutions to manage communal resources or to assign exclusive property rights to individual beneficiaries. Free-rider problems threaten to convert these farms into open access resources leading to environmental degradation and continued poverty.

The original grant program has been criticized for overlooking the needs of prospective farmers who might become successful, commercially oriented producers if they could purchase additional land with financial products that reduce the burden of high loan repayments in the early years of their projects before experience and inflation begin to yield higher nominal returns. Likewise, farm workers could benefit from institutional arrangements that empower them as co-owners (worker-shareholders). These two approaches, reviewed in this paper, are each designed to preserve the commercial orientation of redistributed or reconstituted properties. Both of these institutional innovations are currently being serviced by the Land Reform Credit Facility (LRCF), a new initiative of the Department of Land Affairs that economizes on government resources and induces a broader participation of private sector lenders and venture capital investors in land redistribution efforts.

The first approach, the mortgage loan scheme, finances freehold land purchased by disadvantaged farmers while the second, the equity share scheme, transfers a part of the equity in established farm businesses to farm workers. The first is relatively more elitist in nature given the impact of the

Subdivision Act on minimum farm sizes. The second has a far greater reach down the income scale for its beneficiaries. Both schemes are built around a loan with deferred repayments to alleviate cash flow problems during the early years of the project.

The LRCF was designed to draw on donor funding to cover the period of deferred payments for lenders and investors financing land purchased by disadvantaged buyers. The first funding request by private financiers was completed eight months after the launch of the Facility. As of May 2000 four deferred loan contracts were transacted amounting to R14.6 million. Currently the LRCF has a growing queue of interested lenders and prospective venture capital investors. Nevertheless, five issues need to be addressed for the LRCF to make a significant contribution to the redistribution of commercial farms in South Africa.

First an appropriate and secure host institution needs to be determined for the long term location of the Facility. Second, the operational autonomy of the LRCF from the DLA around pre-agreed approval and disbursement criteria needs to be clarified and made secure. In particular, the LRCF should be allocated a share of the DLA's grants and authorized to award these grants contingent upon the disbursement of a loan. Third, the annual flow of loans from the LRCF to financial intermediaries needs to be forecast accurately to avoid abrupt fluctuations in loan services. To achieve a steady supply of loans to intermediaries and final borrowers that maintains the real value of the Facility in the long run will require a well-crafted simulation model that accounts for existing and anticipated loans, expected changes in inflation and interest rates, administrative costs, bad debt and levels of donor and borrowed funds. Fourth, the LRCF has to be capitalized at scale if it is to keep pace with the growing demand for loans. Failure to address these issues will destroy its credibility among financial intermediaries. Lastly, to strengthen its political credibility, the LRCF must revise its selection criteria to improve on outreach, empowerment, and tenure security in the projects it finances. Repeal of the obsolete Subdivision Act would certainly deepen outreach among aspiring farmers.

In conclusion, the LRCF represents an innovative approach to redistribute commercial farms to promising disadvantaged farmers and farm workers in South Africa. The mortgage loan scheme lays a basis for the growth of a freehold, land owning class of disadvantaged farmers that will be able to compete in a modern agricultural economy. At the same time, a growing share of owner-workers in profitable rural enterprises financed through the equity share scheme ensures a reduction of poverty among current farm workers. The current mandate of the LRCF should be strongly supported to meet these challenging goals for the country.

REFERENCES

BINSWANGER, H.P. (1987). Impact of government policies and legal provisions on land use, land value and agrarian structure: Analytical framework, hypotheses and terms of reference. World Bank Mimeo, Washington, DC.

COCHRANE, A. (2000). Personal communication. Agricultural Advisor, National Department of Land Affairs, Pretoria, South Africa.

DEININGER, K. & BINSWANGER, H.P. (1992). Are large farms more efficient than small ones? Government intervention, large scale agriculture, and resettlement in Kenya, South Africa and Zimbabwe. Unpublished World Bank policy working paper, Washington, DC.

DLA. (1998). Feasibility study for the support of commercial land transfer projects. Unpublished report, National Department of Land Affairs: Redistribution Policy, Pretoria, South Africa.

DLA. (2000). The commercial farmer programme: A component of an integrated land redistribution programme of the Ministry of Agriculture and Land Affairs. Unpublished policy document, draft 2.7, National Departments of Agriculture and Land Affairs, Pretoria, South Africa.

ECKERT, J.B., HAMMAN, J.N. & LOMBARD, J.P. (1996). Perceiving the future: Empowering farmworkers through equity sharing *Development Southern Africa*, 13(5), 693-712.

GRAHAM, A.W. (2000). Land redistribution in KwaZulu-Natal: An analysis of farmland transactions recorded in 1997 and 1998. Unpublished MSc(Agric) thesis, Agricultural Economics, School of Agricultural Sciences and Agribusiness, University of Natal, Pietermaritzburg.

GRAHAM, D.H. & LYNE, M.C. (1999). The cash flow problem and land redistribution in South Africa: Broadening the land market and economising on government's role. *Agrekon*, 38(Special issue):343-352.

LRCF. (1999). The Land Reform Credit Facility: Project Status Report at 16th August 1999. Khula Enterprise Finance Ltd., Johannesburg

LRCF. (2000). The Land Reform Credit Facility: Progress report for the period 4th November 1999- 27th January 2000. Khula Enterprise Finance Ltd., Johannesburg

LYNE, M.C. & ORTMANN, G.F. (1996). Estimating the potential for creating additional livelihoods on commercial farmland in KwaZulu-Natal. In M Lipton, F Ellis & M Lipton, (eds.), *Land, Labour and Livelihoods in Rural South Africa: Volume 2 KwaZulu-Natal and Northern Province*. Indicator Press, University of Natal, Durban.

LYNE, M.C. & GRAHAM, D.H. (2000). The impact of land redistribution on tenure security and agricultural performance in KwaZulu-Natal. Unpublished paper submitted to *World Development*.

NIEUWOUDT, W.L., SCOTT, T.G., SIMKINS, C.E.W. & VINK, N. (1994). Financing land redistribution in South Africa: Putting theory into practice. Proceedings of the Land Redistribution Options Conference, Land and Agricultural Policy Centre, Johannesburg.

NIEUWOUDT, W.L. & VINK, N. (1995). Financing of land purchase by small-scale farmers. *Development Southern Africa*, 12(4):509-17.

PLACE, F., ROTH, M. & HAZELL, P. (1994). Land tenure security and agricultural performance in Africa: Overview of research methodology. In *Searching for Land Tenure Security in Africa*, ed. J.W. Bruce and S.E. Migot-Adholla. Kendall/Hunt, Iowa.

SIMMS, P. (1997). Land redistribution in South Africa - some practical lessons. In *Proceedings of the 11th International Farm Management Congress, Vol. 1*, ed. L. Bauer. International Farm Management Association and The Canadian Farm Business Management Council, Olds, Alberta, Canada:

SPP. (1999). An examination of the impact of share equity schemes on beneficiaries in the Western Cape and Mpumalanga. Unpublished report prepared by the Surplus Peoples Project, Cape town, South Africa.

WORLD BANK. (1993). Options for land reform and rural restructuring in South Africa. Unpublished World Bank Report, World Bank, Southern Africa Department, Washington, D.C.

WORLD BANK. (1994). Summary: Options for land reform and rural restructuring. Proceedings of the Land Redistribution Options Conference, Land and Agricultural Policy Centre, Johannesburg.

Appendix Table A1: Comparison of net cash flows (NCF) projected for an equity-sharing fruit farm

Year	Nominal NCF before loan repayment	Conventional loan repayment	Nominal NCF after loan repayment	Loan with deferred repayment	Nominal NCF after loan repayment
------	(1)	(2)	(3)	(4)	-5
1	198	-210	-12	0	198
2	175	-210	-35	0	175
3	300	-210	90	-274	26
4	346	-210	136	-274	72
5	114	-210	-96	-274	-160
6	453	-210	243	-274	178
7	404	-210	194	-274	129
8	403	-210	193	-274	129
9	139	-210	-71	-274	-135
10	325	-210	115	-274	51
11	228	-210	18	-274	-46
12	633	-210	423	-274	359
13	596		596	-274	322
14	842		842	-274	568
15	919		919		919
16	1,495		1,495		1,495
17	1,700		1,700		1,700
18	1,900		1,900		1,900
19	1,840		1,840		1,840
20	813		813		813

Source: Graham and Lyne (1999).